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### NF91-1 Bankruptcy: Debtor's Last Resort

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## Bankruptcy: Debtor's Last Resort

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*Adapted by Kathy Prochaska-Cue, Family Economics and Management Specialist*

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When all other alternatives for dealing with too many debts (detailed *Solving Financial Problems*, NF 91-6) fail, the Federal Bankruptcy Code provides consumers with two forms of debtor relief. Chapter 7 of the code is the straight bankruptcy provision and provides for liquidation (convert into cash) of the debtor's assets. Under Chapter 7, the secured creditors may have the security turned over to them unless the debtor reaffirms the debt with the court's approval. With bankruptcy under Chapter 7, you give up the property you put up for collateral when using credit unless the debts are reaffirmed by court permission and you continue to pay the creditor. With Chapter 13 you promise to pay existing debts with part of the income you will earn in the next few years. While paying the debts, you will be able to keep things you bought on credit if your plan is approved by the courts.

### Chapter 7-Bankruptcy

Chapter 7 allows a person overburdened with debts to make a fresh start by discharging most of the claims against him or her.

The granting of a discharge after the filing of a bankruptcy petition in Federal court releases or discharges you from the legal responsibility of your debts once the petition is approved. Once the petition is filed, garnishments and lawsuits can be stopped if proper papers are filed with the court; you are protected by the automatic stay provision of the Bankruptcy Code.

Your attorney will file the petition with the Clerk of the United States Bankruptcy Court in the area in which you have been living for the past 6 months. A filing fee must be paid to file. This fee is in addition to fees charged by your attorney for his or her services. You must file a list of all your debts and creditors. A detailed list of all property you own, money owed you, insurance policies owned, as well as property that may be inherited within 6 months also must be filed. You must list property for which you are claiming a homestead exemption. You also must file a detailed statement of your financial affairs.

Once the bankruptcy petition has been filed, a trustee will be appointed by the court. The trustee presides over the first meeting of creditors in the bankruptcy proceeding. The trustee also will liquidate certain assets that are not exempted or the debts reaffirmed, and these proceeds will be distributed to

your creditors.

All your listed creditors are notified and given the option to attend a meeting, at which you will be present, to file claims on the debts you owe them. The court-appointed trustee takes administrative control of your property that is to be sold and delivers property to the secured creditors. Once property has been sold, administrative costs are paid, and the remaining cash is paid proportionately to all creditors.

The bankruptcy court holds a hearing to inform you that your debts have been discharged or gives you a reason why they were not discharged. You may reaffirm certain debts with the court's approval if you desire to keep the collateral and if it is in your best interest. For instance, if you wish to keep your car, you can reaffirm the debt and continue to make payments. You do not have to reaffirm the debt; however, if you do, you become legally liable for the reaffirmed debt. The bankruptcy process takes a number of months from date of filing until date of discharge.

Bankruptcy claims may be voluntary or involuntary; most are voluntary. The only requirement for filing is that the debtor owe one or more debts.

The following debts cannot be eliminated in bankruptcy:

- State and Federal taxes owed within the past 2 years before filing for bankruptcy.
- Money or items received by fraud or false pretenses.
- Unlisted debts, unless creditor had knowledge of bankruptcy filing.
- Child support or alimony.
- Debts incurred by embezzlement, fraud or larceny.
- Willful or malicious injury to another person or person's property by the debtor.
- Government imposed fines or penalties, such as tax penalties.
- Student loans guaranteed by the government or a nonprofit educational institution (except that if paying back the loan would cause undue hardship on the debtor or the debtor's dependents, or if the loan came due 5 years before filing for bankruptcy).

Chapter 7 can be declared only every 6 years. However, if you get in financial trouble before the end of 6 years, you can file Chapter 13.

## **Chapter 13-Wage-Earner's Plan**

Chapter 13 or the wage-earner's plan is a voluntary repayment plan. When you complete the plan you have the satisfaction of keeping your assets, paying your creditors, and discharging your debts.

When filing Chapter 13 you agree to pay approximately 25 percent of your income to the court. The court appoints a trustee to handle your money and pay your debts. The trustee also provides advice and counsel when necessary.

To file Chapter 13; contact an attorney who has experience in filing Chapter 13 petitions. Next:

1. The attorney will file the petition with the Federal court. A court-appointed trustee is responsible for reviewing the petition, confirming the petition, paying the debts, and advising and counseling the debtor.
2. The court clerk will send notice of court action to creditors and the employer.
3. The employer sends a portion of your pay check to the court trustee, who pays creditors. Secured

debts are paid first, followed by unsecured debts.

4. The debtor cannot borrow more money without approval of the court trustee.

The actual amount of money paid creditors depends on the amount owed, the debtor's salary, and the payback time frame. Chapter 13 payment plans may not be proposed for longer than 36 months unless you can show reason for extending the plan. The maximum time allowed is 5 years.

Administrative costs may be high. They include the court costs, filing fee, the attorney's fee, and the trustee's fee for paying off the debts. The trustee also may receive a fee for expenses such as typing equipment and supplies.

There are several advantages to filing Chapter 13 despite the expense. You do not lose your assets. The court protects you from wage garnishment and harassment. All debts are finally discharged though this court provision will remain on record at the credit bureau for 7 years.

It is possible to use credit after bankruptcy is filed, check your payments to make sure you are not making payments on debts discharged by bankruptcy. Some creditors may try to get you to pay back former debts. If both a husband and wife have signed contracts together, both will have to file for bankruptcy to discharge debts. Bankruptcy is shown on your credit file at the credit bureau for 10 years. If you choose to file bankruptcy you may harm your credit rating.

## **Choosing an Attorney**

If you choose to use Chapter 7 or Chapter 13, you will need to hire an attorney. Try to find an attorney who has experience in handling Chapter 7 if you choose to file bankruptcy. Choose an attorney who has experience in handling Chapter 13 (the wage-earner's plan) if you choose to go that route. Some attorneys may handle Chapter 7 and know little about Chapter 13 and vice versa. Select your attorney carefully.

1. Ask friends or relatives if they know of an attorney who has handled Chapter 7 or Chapter 13.
2. Contact the bankruptcy judge's office in your area and ask for the names of several attorneys in your area who file Chapter 7 and Chapter 13 cases.
3. Look in the Yellow Pages of your telephone book. After attorneys have been listed individually, they are sometimes listed by designated areas. Some attorneys designate family law, debtor law, taxation or other specialties. Look to see if names are designated under consumer and debtor law.

## **Summary**

When your debts are high and your monthly income is not enough to cover the payments, the Federal Bankruptcy Code offers two solutions as the last resort. Your debts will be settled by selling your assets when filing bankruptcy. Under the wage-earner's plan you may keep your assets while paying back your debts.

The road to financial recovery takes a total commitment. You have to decide that you want to be free of debt, then discipline yourself to take the needed action. Only you can determine if the last resort solution offered by bankruptcy will help.

*Adapted from: Getting Out of Debt, How to Get Out of Debt, and How Others Can Help You Get Out of Debt.*

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***File NF1 under HOME MANAGEMENT***

***B-1a, Budgeting***

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